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SUBJECT: SECRETARY BODMAN'S MARCH 14 MEETINGS IN KAZAKHSTAN

REF: Almaty 886

1. (SBU) Summary: Secretary Bodman conducted a full day of meetings with Government of Kazakhstan (GOK) officials and energy sector representatives in Astana on March 14, on the eve of the Secretary's G8 energy meetings in Moscow. (Secretary Bodman's meeting with President Nazarbayev is reported Septel.) On the topic of oil and gas pipelines, GOK ministers told Secretary Bodman that the GOK had recently approved a draft of the BTC IGA, and had submitted it to the Azeris with the expectation that the document would be signed in April or May. Several ministers noted the GOK's interest in a Trans-Caspian gas pipeline, as well as in developing a nuclear energy program. Kazakhstan's Minister of Industry and Trade appealed for the elimination of "WTO Plus" conditions for Kazakhstan's accession to the WTO.

2. (SBU) Summary (continued): Secretary Bodman repeatedly voiced USG support for ConocoPhillips' "N Block" bid. The Secretary also urged his interlocutors to assume a greater

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regional leadership role, and to build stronger North-South ties, especially in the field of energy. Following a brief by energy sector representatives on Kazakhstan's challenging investment climate, Secretary Bodman urged his GOK interlocutors to carefully balance Kazakhstan's interests with those of external investors when considering changes to the investment climate. Despite an eleventh hour effort on both sides to reach consensus and sign a Second Line of Defense (SLD) agreement, the GOK pulled back at the last minute, citing an inability to gather the requisite ministerial signatures in time. End Summary.

3. (SBU) In addition to President Nazarbayev, Secretary Bodman's delegation (which included DOE A/S Karen Harbert) met with Minister of Energy and Mineral Resources Baktykozha Ismukhambetov, Minister of Industry and Trade Vladimir Shkolnik, Minister of Foreign Affairs Kasymzhomart Tokayev, Finance Minister Natalya Korzhova, Deputy Prime Minister Karim Masimov, and representatives from American energy companies operating in Kazakhstan.

Pipeline Negotiations

4. (SBU) Secretary Bodman asked all of his GOK interlocutors what could be done to expedite signing of the Baku-Tbilisi-Ceyhan (BTC) Inter-Governmental Agreement (IGA), and to conclude negotiations on expansion of the Caspian Pipeline Consortium (CPC) pipeline. Trade and Industry Minister Shkolnik (the former Energy Minister) explained that the GOK had forwarded a draft BTC-IGA to the Azeris "a month ago," after having "cleaned up the draft initialed in September to ensure compliance with Kazakhstani legislation." Energy Minister Izmukhambetov added that the Azeris had promised to submit proposals in the next few days, with the objective of finalizing the treaty in April. Foreign Minister Tokayev suggested that the Islamic Conference of Foreign Ministers, scheduled to take place in Baku in May, would provide a good setting for signature of the IGA. He noted that either the Prime Minister or Izmukhambetov would be likely to sign for Kazakhstan. Secretary Bodman accepted these assurances of progress, but

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added a cautionary note to Shkolnik: President Nazarbayev had first told him the deal was done in May 2005 in Baku.

5. (SBU) During the Secretary's meeting with representatives of American energy companies, both Chevron and ExxonMobil singled out resolving the CPC expansion impasse as their companies' most critical current issue. Izmukhambetov later voiced optimism that the impasse could be resolved "in the near future," suggesting that his planned April meeting with Russian Energy Minister Khristenko might yield a solution. At any rate, he said, the GOK's position was the same as that of the investors -

"we practically negotiate together."

16. (SBU) Several GOK ministers acknowledged the promise of a potential Trans-Caspian gas pipeline. Tokayev raised the subject in the context of Secretary Bodman's upcoming meeting with EU Energy Ministers in Budapest, underscoring the importance of building "a network of gas supplies" to the EU. Tokayev noted that, even if the pipeline originated in Kazakhstan, Turkmenistan would have to play a critical role as a supplier of gas. Thus, it was important that previous Azerbaijani-Turkmenistani problems on the issue be resolved. This would take an international effort, Tokayev said. "Someone must persuade them to come together."

WTO Accession

17. (SBU) Minister Shkolnik asked Secretary Bodman for his help in eliminating "WTO Plus" conditions for Kazakhstan's accession to the WTO. Lead WTO negotiator Zhanar Aitzhanova argued that, in many cases, Kazakhstan was being asked to do things that recently-acceded countries had not been asked to do. For example, she said, Saudi Arabia had not been asked to unify its pipeline tariffs, but Kazakhstan was. Shkolnik asserted that the strict "WTO Plus" conditions actually worked contrary to the interests of prospective U.S. investors in Kazakhstan. Secretary Bodman promised to raise the issue in Washington. Shkolnik concluded the topic by emphasizing that it was important to Kazakhstan to finalize the WTO negotiation process "this year - sooner than our neighbors."

Energy Minister: Help Us with Chevron

18. (SBU) Secretary Bodman opened his meeting with Izmukhambetov by commenting that, based on his earlier conversation with President Nazarbayev (septel), Kazakhstan appeared ready to expand the U.S. - Kazakhstani Energy Partnership. Secretary Bodman singled out three areas of possible cooperation: nuclear energy, coal, and renewable energy. Izmukhambetov accepted the offer of expanded cooperation, above all in the area of nuclear energy. One of Kazakhstan's immediate objectives, he said, was to reduce its electricity deficit in Southern Kazakhstan by constructing an atomic power plant. The GOK also placed a high priority on developing a petrochemical industry, Izmukhambetov noted.

19. (SBU) Following on his earlier meeting with energy company representatives (paragraph 11), Bodman urged Izmukhambetov to carefully balance the interests of investors with the interests of the country when contemplating changes in the investment climate. Izmukhambetov responded that a key feature of the investment climate was contract stability; he asked for Secretary Bodman's help in holding Chevron to its contractual obligations to pay its Tengiz royalty obligations "in kind." Chevron was resisting a recent GOK request to be paid in oil rather than dollars, he said, for fear that the GOK would then sell the oil to Iran. (Note: See reftel for Chevron's resolve to strictly abide by OFAC requirements, and company concerns about GOK's intentions regarding Tengiz royalty oil. End note.) The GOK, Izmukhambetov said, intended to use the oil for domestic consumption, and was willing to meet Chevron's condition that the oil not be sold to Iran. (Note: KazMunaiGaz President Uzakbay Karabalin told A/S Harbert that the GOK had written a formal letter to Chevron guaranteeing that the royalty oil would not be resold to Iran. End Note.) However, Izmukhambetov continued, despite GOK assurances that the oil would be used domestically, Chevron intended to seek USG permission to deliver royalty oil to the GOK - a process which he hoped Bodman would involve himself with. (Comment: Chevron appears to be taking a careful, legal approach to this issue, creating legal cover for the company in the event some of its royalty oil does end up in Iran. End Comment.)

10. (SBU) Izmukhambetov then complained about the large quantities of sulfur stockpiled at Tengiz, telling Secretary Bodman that the area's high winds were blowing the sulfur into the Caspian and neighboring regions. Izmukhambetov urged Secretary Bodman to persuade Chevron to sell the sulfur. Ambassador Ordway replied that Chevron management also wanted to market the sulfur as rapidly as possible, and had a plan in place to do so. Furthermore, he said, Chevron management believed they were now selling more sulfur than they were producing, thus gradually reducing the stockpile. Secretary Bodman declined to get involved in either issue,

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suggesting to Izmukhambetov that he raise the issue with Chevron's leadership.

Investment Climate

11. (SBU) Secretary Bodman discussed Kazakhstan's investment climate over breakfast on March 14 with representatives from American energy companies operating in Kazakhstan. The company representatives voiced several concerns, beginning with the GOK's tendency to "criminalize civil issues." "You can't make a mistake here," lawyer Marla Valdez said, noting that criminal actions against expatriates were on the rise and that at times the GOK appeared to be using criminal suits - and the threat of them - to leverage company behavior. A second issue was Kazakhstan's strict fiscal code. Terms were sufficiently harsh, Deloitte & Touche's Michael Sturdivant said, that few companies were pursuing new contracts, preferring to acquire companies and fields which were "grandfathered" under earlier, more favorable, fiscal terms. (Comment: In fact major foreign companies are vigorously competing for new blocks, suggesting that interest remains high despite the tough terms on offer. End Comment.) Finally, there was the issue of sanctity of contracts. American Chamber of Commerce President Ken Mack described the process by which the GOK used indirect pressure, such as environmental fines or passage of a retroactive tax law, to coerce a company into "voluntarily" renegotiating an existing contract which the GOK perceived as unfavorable. Ambassador Ordway concluded the conversation by suggesting that the GOK's attempt to "claw back" revenue from early subsoil contracts could be seen as operating according to market principles, in which the GOK and investors searched for the fiscal regime which would balance GOK and investor interests.

ConocoPhillips Advocacy

12. (SBU) Secretary Bodman voiced USG support for ConocoPhillips' "N Block" bid in each of his meetings. Deputy Prime Minister Masimov put Secretary Bodman's efforts in context, noting that President Nazarbayev had already received letters on the subject from Secretaries Gutierrez and Rice. Masimov remarked that American companies had been the first to invest in Kazakhstan after independence - "a fact that is important to us." Nazarbayev, he said, has "given the green light for U.S. investment." In conclusion, he said, "we will consider the ConocoPhillips issue very carefully." Izmukhambetov also implied that ConocoPhillips' bid was still in contention; he informed Bodman that while negotiations were underway with Shell, a decision had not yet been made. If we do not reach agreement with Shell, he said, we will surely work with ConocoPhillips.

GOK Initiatives

13. (SBU) Both Shkolnik and Masimov raised several GOK economic priorities and initiatives in discussion with Secretary Bodman. Shkolnik highlighted the GOK's desire to

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diversify the economy and attract investment in the non-extractive industries. Shkolnik cited the development of a nuclear energy program as a priority, as well as enhancing the competitiveness of Kazakhstan's tradable goods by reducing their energy intensiveness. Shkolnik proposed that the latter issue would make a good joint program with the DOE, with the objective of increasing the number of competitive products Kazakhstan could export to the region. Masimov noted several GOK economic initiatives, including the transformation of Almaty into a regional financial center; the GOK's desire to establish a "world-class" university in Astana; and GOK plans to diversify its economy by buying U.S. companies operating in fields such as information technology, then using the companies' experience to further build the sector within Kazakhstan. For that, Masimov said, "we want the USG's blessing."

Encouraging Kazakhstan's Regional Ties

14. (SBU) Secretary Bodman encouraged all his interlocutors to build on Kazakhstan's economic success and political stability by playing a larger role in the region. Kazakhstan already had well-developed economic ties to the North, East, and West; the U.S. would be pleased to see Kazakhstan increase its ties with its Central and South Asian neighbors, and develop a true "North-South energy relationship." Bodman remarked that he had traveled to Kazakhstan from Pakistan, where he had found the Pakistanis eager to expand their cooperation with Kazakhstan. The GOK ministers welcomed the idea. Masimov told Secretary Bodman that, while Kazakhstan was accustomed to interacting with the Central Asian states, intensifying relations with Afghanistan and Pakistan was "a new, but welcome idea for us."

SLD Agreement: Last-Minute Letdown

15. (SBU) In the weeks leading up to Secretary Bodman's trip to Kazakhstan, both the DOE and Embassy intensified efforts to reach agreement with the GOK on the text of a Second Line of Defense Agreement implementing arrangement, using the Secretary's arrival as an inducement to conclude the lengthy negotiation process. Days before the Secretary's arrival, the MFA signaled that agreement would

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not be reached in time for Secretary Bodman's signature, only to reverse itself on March 13, provoking a flurry of last-minute negotiations over the text. In a 4:00 pm meeting, Masimov told the Secretary that the agreement would be ready in time for signature over dinner. However, at the last moment, Minister of Finance Korzhova declined to sign the document on the grounds that all the requisite ministerial approvals had not been obtained. We will vigorously pursue signature as soon as possible.

16. (U) Secretary Bodman's delegation did not have the opportunity to clear this cable.

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